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COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

STATEMENT BY

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BEFORE

**COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE**

**IMPROVING FINANCIAL AND MATERIEL MANAGEMENT
THE DEPARTMENT OF DEFENSE**

MARCH 6, 1990

Mr. Chairman and members of the committee,

I am pleased to be before the Committee today to discuss the strength of our financial and material management systems.

These matters have generated quite a bit of comment lately which are of concern to me. A recent GAO report on Air Force financial management operations suggests that we had insufficient control over property and inventory assets, unsupported adjustments and inaccurate reporting in our accounting systems. The Senate Budget Committee's majority staff report questioned the need for over \$30 billion in inventory items and other GAO reports have addressed needed improvements in materiel management.

These issues, among many others, led Secretary Cheney and me in our efforts to focus the Defense Management Report (DMR) toward a fundamental reform of the acquisition and management process. We are doing this by continuously challenging the ways our organization does business. In looking at requirements across DoD, we feel there are redundant, Service unique systems and operations lacking overall integration. We have generated new and creative initiatives to change our business operations. Our changes involve interrelated efforts primarily directed to support activities.

Under the DMR umbrella, I have also launched a Corporate Information Management initiative to integrate the data flow within common functional areas.

- DMR and Corporate Information Management initiatives are changing management techniques and structures, as well as information system integration perspectives and requirements. These initiatives will change the supply, inventory and accounting process and create design requirements for new DoD-wide integrated systems with common approaches in seven initial functional areas. Representatives from each Military Department and the defense agencies are working in functional groups to achieve these objectives. The initiative starting dates are in parentheses.

- Distribution Centers (12/89)
- Civilian Payroll (12/89)
- Financial Operations (3/90)
- Materiel Management (4/90)
- Contract Payment (4/90)
- Civilian Personnel (4/90)
- Medical (4/90)

These efforts are intended to eliminate separate Service systems and provide integrated systems that can relate to each other, as well as across all of DoD. The systems will provide management at every level with useful and timely information. Contract data will integrate with fund controls, contractor material requisitions, delivered items and warehouse stocks, as well as payment and accounting requirements.

- Consolidation Studies are underway to eliminate unnecessary organizational layers of personnel and non-value added functions. Reports on seven initial studies will be delivered to me by May 1, 1990. These studies will review consolidation proposals and provide detailed implementation plans for:

- Supply Depots
- Inventory Control Points
- Aeronautical Maintenance Depots
- Accounting Operations and Finance Centers
- Other Maintenance Depots
- R&D Laboratories
- ADP Operations and Design Centers

As is apparent from these initiatives, our actions are designed to solve the very concerns raised in the various reports. About half of our initiatives deal with the topics at this hearing. In addition, recent world events have reinforced and accelerated the need for these actions and initiatives. This is only the beginning of the cultural change we seek to achieve in the Department.

My subsequent comments on the particular matters at hand should be considered within the overall management plan, perspective and context which I just outlined. With that view point in mind, I would like to update you on our efforts to improve the material management process. An efficient and effective supply and inventory management system is a primary objective of the DoD. At the same time, we recognize that meaningful solutions will require the commitment of both the Administration and Congress.

MATERIEL MANAGEMENT

The DoD inventory management program is the largest in the world. It includes an inventory valued at approximately \$100 billion, composed of nearly 5 million different items. The

purpose of the inventory is to provide replacement parts and other consumable items to maintain the readiness and staying power of our ships, aircraft, tanks, and other complex weapon systems used by our military forces. Quality weapon system support is one of the most important factors in the defense readiness equation; and today, as our Armed Forces demonstrated in Panama, our readiness is at a record high. We all agree that we need an inventory of spare parts to sustain our forces. What is at question is whether the Department is investing taxpayer dollars wisely in the selection and quantity of procured items and whether we are managing these inventories effectively and efficiently using integrated systems that provide item visibility and financial control.

The sheer size of the Department's inventories reflects the defense strategy of the 1980s which called for a major modernization effort and the development of a number of new weapons systems to transition rapidly from a "hollow" force to a military posture capable of executing the national security strategy. The \$100 billion in spares and material supports nearly \$400 billion invested in military capital equipment.

I would now like to take a few minutes to highlight what we have accomplished and where we plan to concentrate our efforts in the future.

DEFENSE MANAGEMENT REPORT (DMR) AND CORPORATE INFORMATION MANAGEMENT (CIM)

The DoD is engaged in a sustained, long-term effort to streamline its management, with a special emphasis on the Defense logistics infrastructure and supporting functional systems. DoD's approach to achieving efficiencies includes improving the quality of management using integrated functional systems support, while reducing overall costs.

REDUCING INVENTORY BUYS AND REDUCING ON-HAND INVENTORY

As a result of dramatic world events and anticipated reductions in forces and weapon systems, the Department is undertaking two major actions: (1) to reduce what we buy for the inventory each year, which has a dollar impact on the budget, and (2) to dispose of inventory on-hand which is no longer needed to support weapon systems or previous threat scenarios.

REDUCING WHAT WE BUY

Within the Department's comprehensive plan, initiatives underway to reduce what we buy annually include:

Procurement Lead Time Reduction

Procurement lead times determine the amount of stock we must carry --- the longer the lead time, the more inventory we must stock to ensure against extended delivery schedules and interrupted sources of supply. Recognizing the potential for

significant savings if procurement lead times are reduced, the Department has targeted this area for major improvements. The various DMR and CIM initiatives will provide integrated item and cost information to the managers responsible for buying supplies. In December 1986 and April 1989, we issued guidance to the Services to reduce procurement lead times. In May 1989, the Department conducted a Procurement Lead Time Reduction Conference attended by senior inventory management and procurement personnel from all the Components to seek additional ideas and approaches for reducing procurement lead times. As a follow-on, a joint DoD/Industry task force is currently identifying specific implementation actions to reduce lead time. Other initiatives include better automation tools for the procurement process, greater use of multiyear contracting, and regulatory relief to remove impediments to timely procurements.

Revised Order Quantity Policy

Several years ago, in an attempt to obtain better price breaks on larger buys of spare parts, the Services and the Defense Logistics Agency began buying one year's worth of some items (previously smaller quantities were purchased on a more frequent basis using economic order quantity computations). In some cases, the annual buys were more economical; however, for many items the annual buys contributed to greater on-hand inventories and related holding costs with little improvement in prices. A number of audits found that an "annual" buy program increases the risk of buying items that will go into the

inactive inventory. The Department issued guidance in June 1989 which ended the practice of annual buys and reestablished the procedures of using economic order quantity computations. However, to ensure that the Department did not swing too far in the other direction, guidance now requires the DoD Components to solicit routinely quantity price discounts. The DoD-wide CIM systems I previously mentioned should assist in determining the economical order points based on requisitioned items, holding and acquisition costs.

Use of Commercial Items and Distribution Systems

DoD initiatives to use commercial items and distribution systems include: (1) authorizing local purchase of non-weapon related supplies up to \$5,000 per line item when this represents the best value; (2) "just-in-time" arrangements to deliver materiel directly from contractors to users; and (3) a series of regulatory and policy revisions to increase DoD's use of the GSA Federal Supply Schedule program. The net result has been a 36 percent increase over the last year in the use of commercial items and distribution systems (from \$1.4 billion in FY 1988 to \$1.9 billion in FY 1989). Integrated CIM systems should provide even more relevant management data than now available and allow even greater item and buying visibility.

Item Identification and Reduction

With almost five million items in the DoD inventory, the task of identifying and minimizing duplicate items is a

significant challenge. The Federal Catalog System was originated in 1952 with this objective in mind. To the extent possible, automation is being used to scrutinize candidate additions to the inventory. The Department is presently in source selection for a new system called "Cataloging Tools on Line" (CTOL), an automated work station approach to cataloging new items as they are received from the provisioning process. CTOL will permit a more comprehensive review for item identification, which should prevent duplications from entering the inventory system. We expect this new capability to increase productivity by 30 percent.

To improve the solicitation process even further, the Department is acquiring a "Federal Logistics Data On Compact Disc" (FEDLOG) capability. FEDLOG places the entire federal catalog, plus selected Service data bases, on Compact Disc Read Only Memory (CD-ROM). This medium will allow users to research logistics data records quickly for the correct item to meet mission needs. The retrieval software also simplifies the identification of potential duplicate items that may be in the existing file. Adding this new capability will reduce the number of activities performing the cataloging function. Consolidation should inject greater discipline in the item identification process, resulting in better use of the CTOL and a probable reduction in overhead and administrative support costs. Our ongoing CIM materiel, supply and inventory system initiatives should eclipse these individual systems and provide far more comprehensive data for managers at all levels. The

consolidation studies should add an even greater dimension to the efficiency and effectiveness within these functions and across DoD.

Improved Initial Provisioning

"Provisioning" is the supply process that introduces the initial order of spares and repair parts to support a newly-fielded weapon system. This process predicts the type and number of spare parts needed before actual demand experience is available. It is an engineering estimate of what will be needed. In March 1989, we directed a comprehensive review of the provisioning process to determine if provisioning was contributing to inventory growth, particularly since we had just emerged from an extended period of new weapon system acquisitions. Even though the task group found the provisioning process to be a small contributor to inventory growth, the review confirmed the need to improve the process to generate additional savings.

Responsive Reductions to Requirements

The Department is assessing whether extraordinary inventory management actions may be necessary to respond to anticipated force structure reductions, as they relate to reparable and consumable item management. Reparable items are the most expensive spares in our inventory, and, as the name implies, are repaired and reused after they fail. (An example of a reparable item would be a fuel control unit on an aircraft engine.)

Requirements for reparable items are based on future training requirements (i.e., number of flying hours) and estimates of wartime utilization for the end items (i.e., aircraft) supported. Adjustments for force structure changes or reductions in operations are currently done through an automated process, which imply that the current system should be responsive to dynamic changes; however, we will monitor this activity closely.

Requirements for consumable items, which are generally piece parts for repairing end items and other items consumed in use, are based primarily on past demand. Adjustments to force structure changes for consumable items will be more difficult; however, the Department is currently developing the means to refine requirements linked to projected end item availability. We want to recognize, with the current complication of long lead times, that a sudden drop in demands could force on-order items into the inactive inventory; but management will be proactive in monitoring this activity. CIM initiatives should obviate the existing system and should greatly enhance our monitoring capability by detecting and projecting demands even more accurately and timely.

On-Order Contract Terminations

After the requirement is identified, and the contract award has been made, changes in mission or demand occasionally make all or a part of an order for material move into the inactive category, items not consumed within two years. In order to

preclude these kinds of orders from entering the inventory, DoD issued guidance on contract terminations to the field in December 1989. This guidance reemphasized the need to review and verify requirements prior to contract award and provided criteria to determine whether post-award termination of contracts is in the best interest of the Government.

REDUCING ON-HAND INVENTORY

What has already been procured, delivered, and stocked in our warehouses is money already spent, which means that reductions in the on-hand inventory do not generate a reduction in annual "procurement" dollars. Disposal of inventory does, however, reduce the cost of holding the material and reduce our requirements for warehouse space, both of which are sufficient reasons for reducing the on-hand inventory. (Reduced space requirements do not address the need to upgrade or replace older warehouses.) The CIM initiative on warehousing (distribution centers) in conjunction with the other related initiatives will upgrade DoD-wide visibility over holding and space costs and requirements. Other initiatives to reduce on-hand inventory include:

Revision of the DoD Retention and Disposal Policy

During the late 1970s, the Department was under heavy criticism by the GAO for disposing of material that was still usable on weapon systems in the inventory, regardless of the number of years of supply on hand. Being responsive, the Department issued a new policy to retain all material, even

though we understood it would migrate into an inactive inventory. Over time, that policy change accumulated a larger-than-expected inactive inventory. Now the Department is under an opposite pressure to reduce the overall size of the inventory by disposing of the material.

Material has also been retained as the result of the military buildup of the 1980s. Logically, retaining material that would eventually be used by an expanding and modernized force made good economic sense. Now, with a probable reduction in force structure and operating requirements, we are reevaluating our retention policy.

In our support of efforts to reduce inventories, we must, however, guard against sudden, abrupt changes in policy which may (1) reduce readiness or (2) overwhelm our ability to dispose of unneeded material properly. Our plans are to permit an orderly, systematic implementation of new retention rules. We will concentrate first on reducing stocks of unserviceable and obsolete items, and will then evaluate stocks held for economic or contingency reasons. We will also look for opportunities to transfer material to meet foreign military sales needs, support humanitarian assistance programs, or satisfy low-intensity conflict requirements of other nations.

We are particularly concerned about the ability of the DoD, Federal, and State disposal programs to process large amounts of material in a short period of time. We are already pursuing alternative procedures to accelerate disposals in an orderly fashion such as sales in place, reduced screening periods, and

the use of storage space freed up by base closures as temporary materiel staging areas.

Our efforts to dispose of material is already showing results. Disposal of unserviceable and obsolete items have increased 30 percent over the last year (from \$6.5 billion in FY 1988 to \$8.4 billion in FY 1989).

A recent Senate Budget Committee report alleged that \$30 billion of our spare parts are unneeded. This is simply not the case. Instead, \$21 billion of that \$30 billion in inventories are spares and supplies needed to support existing weapon systems or personnel beyond the end of the next budget year. These inventories, which have been referred to as "inapplicable" are more appropriately termed "inactive." One reason for retaining inactive spares is to continue support for older weapon systems, long out of production but still in use by our forces, allies, and friendly nations. Another reason is the high variability of demand for spare parts supporting today's complex weapons. Forecasting spares requirements two to three years in advance of delivery is not an exact science. Long procurement lead time between initial order and final delivery is a major contributing factor. That complication is one of the major targets of the Department's comprehensive integrated program to improve current buying policies and processes. We fully expect the various CIM initiatives for supply and inventory will provide a fully integrated creative approach to the matching of program needs to acquisition buys.

Nine percent (\$9 billion) of our supply inventory is currently classified as "potential excess," materiel the Department does not expect to use in the future. This is less than what GAO attributed (\$10 billion) to the Air Force in their report on financial management. Use of the term "excess" is also inappropriate, especially when applied to the larger inactive inventory (\$30 billion). A more accurate term is "unserviceable and obsolete." Approximately two-thirds of the dollar value of what is appropriately called "unserviceable and obsolete" is unserviceable items that were needed, used, and were, in fact, used to the point that they are now in need of further repair or are uneconomical to repair. The other one-third is made up of obsolete items, largely a direct result of a decade of modernization.

Warehouse Construction

Recent congressional reports have alleged that DoD has initiated millions of dollars of new warehouse construction for the purpose of holding our purchases of "unneeded" inventory. This allegation is incorrect and purports to cast a dark shadow on the congressional committees who have worked in partnership with the Department to achieve a balanced, well planned, military construction program. The facts are that current DoD expenditures on warehouse construction are intended to improve productivity through modernization, replace damaged or outdated structures, or comply with new environmental standards for storage of hazardous material. During the past five years, the

total net square footage available for materiel storage has actually declined by 4.5 percent. This emphasis has been on "replacement" facilities, not expansion.

Moreover, warehouse modernization improves inventory accuracy by improving warehouse location and retrieval capabilities. Our ability to find materiel in the proper warehouse location is up to 97.7 percent, an enviable record of performance for any large business. Even so, the CIM warehouse initiative, which will provide an integrated DoD-wide perspective, should improve that identification capability.

OTHER INITIATIVES TO REDUCE THE COST OF DOING BUSINESS

Defense Management Report

A portion of the Defense Management Report addresses initiatives to improve the overall management of the supply system. Specifically, our efforts to reduce supply systems costs have identified areas in which an initial 3 percent reduction in the cost of managing materiel is anticipated. Proposed changes in the process to generate the savings include multiyear contracting, use of the Stock Fund to finance the acquisition or update of drawings and technical data for "best value" reprocurement actions, and use of the stock fund to procure forgings and castings to reduce substantially procurement lead times.

Modernization of Inventory Management Information Systems

The Modernization of the Defense Logistics Standard Systems (MODELS) consists of a redesign of all of the DoD's logistics business transactions using commercial electronic data interchange (EDI) technology and developing a structure of electronic "gateways" through which all electronic logistics traffic will pass. This technology improvement will establish a new "flexible standard" for transmitting logistics business transactions. The initial version of MODELS is scheduled for implementation in late 1991. The initial prototype tests at six Military Service and Defense Agency sites have been successful, and expansion from the initial test mode to the first pilot operational net is proceeding on schedule. Our CIM initiatives are expected to capitalize and extend such technology on an even broader basis throughout the entire DoD community.

Spare Parts Pricing

The Department has made substantial progress since 1984 to identify and correct root causes of potential overpricing. Over 500 initiatives have been institutionalized by the Services and DLA through programs such as the Navy "Buy Our Spares Smart" (BOSS) program.

Voluntary refunds, where the Government has no direct contractual right to obtain compensation for a perceived overcharge, have been effective. The private sector is aware that the Government will pursue reconciliation for overpricing, even after contract award and payment, as well as other actions when fraud or defective pricing are involved. The numbers of

refunds are down, which implies that our message to supply sources has been effective.

Stock Funding of Depot Level Reparables

Based on a successful Navy test, the Department is expanding, under a DMR initiative, its program to finance the procurement and repair of reparable items with Stock Funds to the Army and the Air Force. Under the stock fund concept, users must reimburse the Stock Fund with operating funds rather than receiving them "free" as they do when reparables are financed through central appropriations. By establishing a buyer-seller relationship, users are better motivated to conserve items and repair only what they need. The Navy's implementation of stock funding depot level reparables decreased procurement and maintenance costs while increasing stock availability and weapon system readiness. The Department believes that the Army and Air Force will realize similar benefits from this DMR change which is proposed in the fiscal year 1991 budget.

Non-Conforming Parts

Recent audits have centered on parts in the inventory that do not conform to the specifications of the original contract. An action plan for correcting root causes of non-conformance was developed by the Services and DLA. This plan contains 26 objectives addressing the pre-contract, contract award, and contract administration phases of procurement. DLA has already

implemented major elements of the plan, well ahead of projected milestone dates.

Diminishing Manufacturing Sources

DoD established a Diminishing Manufacturing Sources task force to develop an implementation plan to reduce the impact of lost sources of supply, and to find alternate sources to overcome the short-notice problem. At the same time, we have also been working with industry's Multi-Association Working Group to address the problems from their point of view, as well. The plan includes such actions as improving life-of-type buy calculations, motivating industry to provide advance notification of intentions to discontinue production, and encouraging "after-market manufacturers" to buy existing manufacturing technology and production lines to ensure continued support to DoD.

Physical Inventory Management

The DoD physical inventory control program is composed of five major elements: (1) location audits, (2) physical inventories, (3) research, (4) quality control, and (5) performance measurement. The overall thrust of the program is to concentrate limited resources to fix problems with the greatest dollar impact on DoD operations. The CIM initiatives cutting across materiel management operations should enhance our abilities to deal more effectively and efficiently with these major elements.

Maintaining accurate inventory records is a continuous and significant workload in DoD. Annually the Department conducts approximately 9 million warehouse location audits, 18 million record reconciliations, and physically inventories 3 million items. While the effort put forth in this area is formidable, the payoff makes it well worth the investment. Over 99 percent of the 39 million demands for materiel placed on the warehouses during FY 1989 were completely satisfied, again an enviable record for any large business.

While errors do occur, such as the 80,000 jungle camouflage helmet covers contained in the staff report to the Senate Budget Committee, these anomalies are genuinely the exception rather than the rule. During the past several years, the GAO conducted seven independent sample inventories, with resultant unit and dollar value accuracy rates of approximately 95 percent.

While the Department's physical inventory control program has been able to cope successfully with substantially larger inventories and maintain or improve accuracy levels, the Department is continually striving for even higher levels of inventory accuracy and better security. To do so, the Department institutionalized a continuous improvement process through the annual Physical Inventory Control Program Plan (PICPP). The plan sets priorities and establishes guidelines for targeted process improvements over the next five years.

Applications of technologies such as bar coding, microcircuits, and radio frequency transmission are reducing human errors in data collection, recording, and transmission.

The increased use of statistical techniques for process quality control are pinpointing more precisely where management attention is needed. The modernizing of ADP systems is improving the quality and timeliness of information needed for disciplined management and control. Ultimately, moving to a single asset balance record system tied into our CIM financial operations accounting system should eliminate the need to reconcile multiple records and ameliorate a major source of inventory variances.

The automation of depot operations and use of automated storage and retrieval systems is substantially reducing manpower-intensive tasks. Sophisticated control systems are also reducing the opportunity for pilferage and theft. Improved automated inventory techniques will flag for investigation any unusual movement or loss of items. In addition, new warehouse facilities are inherently more secure than the aging facilities they replace, since internal security and resistance to external forced entry are part of the basic facility design. All of these physical inventory management initiatives are expected to be institutionalized by CIM functional requirements and integrated with financial operations.

Within the past six months the Department has submitted two reports to the Congress, "Inventory Security & Control Procedures Review and Modernization Plan," dated September 1989, and "Security & Control of Supplies for Fiscal Year 1989", dated January 1990. The two reports document the Department's comprehensive assessment of our system, its accomplishments to

date, and our ongoing plans and programs for further improvement. A copy of each report can be made available for the record.

RECOGNITION OF IMPROVEMENTS ALREADY UNDERWAY

As the committee indicated in its recent letter to the Secretary of Defense, the current level of defense requirements is indeed, uncertain. Responses to these dynamic world changes are particularly difficult, given the inexact science of forecasting materiel demand. Despite the challenges of long lead times for budget development and approval, and lengthy procurement lead times, we have already made significant adjustments to our FY 1991 budget requirements for spares, currently under congressional review, by reducing materiel acquisition budget requirements by \$1.3 billion. These reductions were made possible as the result of actual or anticipated decreases in materiel safety levels, procurement lead time, non-demand based stockage, and materiel on-order.

ACTIONS FOR THE FUTURE

We have already made significant progress toward improving the Department's overall materiel management system and supply operations. Clearly, much remains to be done. We must evaluate each of our inventory management processes currently underway, to determine the appropriate composition of DoD inventories and to restructure budget requirements that will preserve military

capability while reducing the cost of doing business.

Specifically, we intend to:

1. Develop the ability to respond quickly to changes in force structure, base closures, and organizational realignments.

2. Establish quantitative goals to measure progress toward reducing on-hand inventory, procurement lead times, repair cycle times, and order quantities.

3. Revise retention policies and procedures for the timely and orderly disposal of materiel.

4. Pursue vigorously all practical alternatives to increase the use of commercial items, just-in-time techniques, and electronic ordering.

We intend to take a hard look at the incentives that drive our people to do what they do. Through the CIM initiatives, we will encourage the use of better business practices by providing complete data visibility to our managers who are responsible for developing requirements and purchasing inventory. Our objective in this comprehensive integrated review is to make best use of the taxpayer's dollar.

SENATE BUDGET COMMITTEE REPORT

With regard to the three recommendations of the Senate Budget Committee report, I am pleased to tell you that the Department has already taken aggressive steps. For example, we responded to our Inspector General's report of last November, which cited the \$1.8 billion worth of spares above new requirements but still on order, by issuing a new policy on

contract terminations, cited in the staff report. This change is reflected in the \$1.3 billion reduction in the FY 1991 spares budget request.

IN SUMMARY

What has transpired in the past we can do little about. From this point forward...and since we are all in this together...we must work together earnestly to put in place a process for continuous improvement, to govern our inventory management practices--now and in the coming years--for a newly defined military force capability. However complex the task may be, we have charted a course using DMR and CIM initiatives to reduce the cost of stewardship, while preserving the fundamental military capability of the United States.

Now let me turn to another issue which I know greatly concerns this committee. This is the issue of GAO's audit of the Air Force's financial operations.

FINANCIAL MANAGEMENT

Recently, the GAO released its findings following an audit of the Air Force's financial management operations. The report concluded that there was a lack of control over property and inventory assets, unsupported adjustments, and inaccurate reporting in the Air Force's accounting systems.

As a former corporate official and long-time taxpayer, I recognize the need for large organizations like the Department

of Defense to have effective financial controls. I have been concerned about the basic accounting controls in DoD and agree that they are not up to the standard of those found in most large private-sector organizations. Because of these and similar concerns, President Bush and Secretary Cheney approved a series of initiatives clustered under the umbrella of the Defense Management Report. In this particular area, the Department already has initiatives underway to address many of the problems identified by the GAO.

Before I describe in more detail the actions being taken to resolve the problems, let me clear up one point that has been raised as a result of the GAO report. There is a perception in the media that the GAO report shows that the Air Force and the DoD have inaccurately reported the cost of DoD weapons systems to the Congress and to the public. It is clear that the records examined by GAO did not agree with the budgetary data provided to Congress. We feel confident that the budgetary data provided to Congress have been accurate because it is specifically collected from numerous financial sources for reporting in the Selected Acquisition Reports (SARs). The GAO acknowledges, the data reported on SARs are generally accurate. Moreover, GAO concluded that our funds control procedures assured that spending limits are not exceeded and this system is working effectively.

Nevertheless, this does not lessen the need to make all our accounting and financial documents whole and consistent throughout the Department. Let me describe how several of the

initiatives we have begun over the last couple of months are aimed at the problems identified in the GAO report.

DOUBLE ENTRY BOOKKEEPING

GAO criticized the absence of a double entry bookkeeping system. This tool is an absolute requirement in the private sector; however, it is not as widely employed in the public sector. In the Government, the establishment of a double-entry system requires the use of the governmentwide standard general ledger advocated by OMB and the Treasury Department. Our DoD-wide single integrated accounting system initiative, which just started as part of the DMR effort on Corporate Information Management, will incorporate this governmentwide standard general ledger and chart of accounts. The system will also comply with standard accrual requirements, record actual costs and provide cost visibility on a consistent basis throughout the Department. Furthermore, the system will preclude arbitrary or unsupported adjustments of the kind found by GAO in the Air Force. Adjustments would require written management authorization.

PROPERTY AND INVENTORY ACCOUNTING

The GAO also faults the Air Force because it did not properly account for or control physical assets. This has been another longstanding problem throughout the Department. Our DMR initiative on the development of standard systems will assure control of these assets from acquisition to consumption, or to

disposal, and will track the assets at every level. This will be done both through a standard financial accounting system and through an integrated materiel management system which will provide source data for the accounting system.

GOVERNMENT FURNISHED MATERIAL

The GAO also reported that Air Force property systems do not track military hardware, or government-owned material in the hands of contractors. This problem has also been long known and, prior to the DMR effort, no effective solution had been attempted. However, as part of DMR we have decided that complete accounting control will be established over all government material, or other government property, in the hands of contractors. This effort is a part of the single accounting initiative and will be integrated with the initiative for a DoD-wide materiel management system. The net result will be that DoD will account for and have control over material in the hands of government contractors at all times.

CONSOLIDATION

In addition, another group is studying the potential consolidation of accounting operations and finance centers throughout DoD. While GAO did not address this issue, we believe that streamlining and reducing the number of sites charged with keeping the books for DoD could provide better accounting discipline, as well as save money.

We already have teams working busily on these and other DMR and CIM initiatives as outlined in my preceding comments. Although final decisions are still in the future and must await the groups' proposals, I will give these consolidation initiatives a great deal of attention.

Mr. Chairman, I also know that the GAO plans to do similar audits in the Army and Navy to determine the extent of the problems in those accounting systems. Because we believe that the GAO will find many of the same conditions in these other Military Departments, I do not feel we can wait for the GAO reports to identify for us other issues which may need to be acted upon beyond those I have outlined above. Therefore, I have asked Sean O'Keefe, the DoD Comptroller, to review the state of DoD accounting systems and to report to me by May 1, 1990, his recommendations as to additional actions, or accelerated actions that may need to be taken to address both my concerns and the concerns of the Congress.

IN SUMMARY

I will end my testimony by assuring you Mr. Chairman and members of the committee that the initiatives I have just outlined for materiel management and financial management go to the heart of the problems found by GAO. DoD needs a standardized and consolidated accounting system under general ledger control where all property and inventory account values can be reconciled to physical counts of property, materials and

supplies and discrepancies can be investigated and documented. DoD financial statements must not only record our budgetary control over funds appropriated to us but also accurately and reliably record our stewardship over all assets and resources entrusted to our care and control. Finally, information required by Congress for weapon systems costs must tie into all our accounting records. The Department is committed to achieving this goal.

As you can see, we have designed specific initiatives in relation to identified problems which we've been working on since the President tasked us with the management review last year. The Secretary and I fully appreciate your constructive recommendations and will factor them into our implementation plans at every opportunity.

I believe that we have accomplished a great deal in the last year. But, DoD can do much more to improve the management of our nation's defenses. We could accomplish far more still with the assistance of Congress. By taking down statutory barriers to reducing obsolete inventories and eliminating the number of congressional amendments which require the Services to procure items in addition to or in excess of specific demand requirements, we could jointly take great steps to reducing the size of DoD's inventory.

Mr. Chairman this concludes my prepared statement. I will be pleased to answer any questions from you and other committee members.